STATE OF ARIZONA

Joint Legislative Budget Committee

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1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

http://www.azleg.state.az.us/jlbc.htm

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R E V I S E D

JOINT LEGISLATIVE BUDGET COMMITTEE
Thursday, July 21, 2005
9:30 a.m.
House Hearing Room 4

MEETING NOTICE

- Call to Order

- Approval of Minutes of June 28, 2005.

- DIRECTOR'S REPORT (if necessary).

- EXECUTIVE SESSION
  - A. Arizona Department of Administration - Review for Committee the Planned Contribution Strategy for State Employee Health Plans as required under A.R.S. § 38-658A.
  - B. Arizona Department of Administration - Risk Management Annual Report.

1. DEPARTMENT OF ECONOMIC SECURITY - Review of FY 2006 Expenditure Plan for Workforce Investment Act Monies.

2. DEPARTMENT OF HEALTH SERVICES - Review of Behavioral Health Title XIX Capitation Rates.

3. JOINT LEGISLATIVE BUDGET COMMITTEE STAFF - Report on Phoenix Medical Campus.

4. **DEPARTMENT OF CORRECTIONS - Report on Health Care Contracts.**

The Chairman reserves the right to set the order of the agenda.
07/19/05

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HOUSE OF
REPRESENTATIVES

MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

June 28, 2005

The Chairman called the meeting to order at 9:40 a.m., Tuesday, June 28, 2005, in House Hearing Room 4. The following were present:

Members:	Representative Pearce, Chairman	Senator Burns, Vice-Chairman
	Representative Boone	Senator Bee
	Representative Burton Cahill	Senator Cannell
	Representative Gorman	Senator Martin
	Representative Huffman	Senator Waring
	Representative Tully	
Absent:	Representative Biggs	Senator Arzberger
	Representative Lopez	Senator Garcia
		Senator Harper

APPROVAL OF MINUTES

Representative Pearce moved *that the Committee approve the minutes of May 11, 2004.* The motion carried.

EXECUTIVE SESSION

Senator Burns moved *that the Committee go into Executive Session.* The motion carried.

At 9:42 a.m., the Joint Legislative Budget Committee went into Executive Session.

Senator Burns moved *that the Committee reconvene into open session.* The motion carried.

At 9:50 a.m. the Committee reconvened into open session.

Senator Burns moved *that the Committee approve the recommended settlement proposal by the Attorney General's Office in the case of Monje v. State of Arizona, et al.* The motion carried.

Senator Burns moved *that the Committee approve the 1.7% salary increase for the Director of the Joint Legislative Budget Committee as provided for other state employees.* The motion carried.

DIRECTOR'S REPORT

Mr. Richard Stavneak, Director, JLBC Staff, gave an update on the status of the state budget.

ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS) – Review of KidsCare Behavioral Health Capitation Rate Changes.

Mr. Stefan Shepherd, JLBC Staff, said this item is a review of the KidsCare Behavioral Health capitation rate changes. This is one portion of the Behavioral Health system that is funded in the AHCCCS budget instead of the DHS budget. The requested capitation rate increases are about 5% and are within the budgeted amount for FY 2006.

Senator Burns moved *that the Committee give a favorable review to the Arizona Health Care Cost Containment System's, KidsCare Behavioral Health capitation rate changes.* The motion carried.

DEPARTMENT OF ECONOMIC SECURITY (DES)

A. Review of Transfer of Appropriations for TANF Cash Benefit Monies.

Mr. Eric Jorgensen, JLBC Staff, said this item is a request for a review of a transfer of Federal TANF Block Grant monies in the amount of $12 million. Using a table in the JLBC Agenda Book Mr. Jorgensen explained the DES projected shortfall and possible funding sources to alleviate the shortfalls. He said that the transfer is possible because of the $12 million surplus in the TANF Cash Benefits line item and this is due to declining TANF caseloads. In addition to an improving economy, the department has also identified a program that diverts would-be benefit recipients by providing a one-time payment to help them overcome immediate obstacles.

Representative Tully asked if the $800,000 for electronic transfers was a bank fee.

Mr. Jorgensen said yes, that it was for contracted services for the costs of electronic transfers.

Representative Gorman asked about the Children's Services shortfall and what the Governor did concerning that program.

Mr. Jorgensen said there were some lump sum reductions that were put into the budget and those were vetoed, which essentially negated the lump sum reduction and increased the amount of funding.

Senator Burns asked how the department is going to resolve the shortfalls that do not require JLBC review.

Ms. Lynne Smith, Assistant Director for the Division of Business and Finance, DES, said for Permanent Guardianship they are doing a transfer from the TANF Jobs line item, in keeping with the recommendation of JLBC Staff to use savings and other available monies first before using the Cash Assistance transfer. For the Adoption Services they have identified $300,000 in other surpluses; $450,000 in federal non-appropriated monies, $50,000 in client trust fund monies, and $1.2 million identified from the Cash Assistance transfer. For Children Services they have identified Tobacco Tax Funds ($1.5 million), the Governor's Drug Policy monies, Child Abuse Prevention monies, and transfers from other areas.

Senator Burns asked if they have shortfalls in the future, will they be able to use some of the same funds to alleviate the shortfall.

Ms. Smith said that they always look for flexibility from department savings and Federal Funds first.

Senator Burns asked for an explanation on why some monies were not being spent from the Healthy Families Fund.

Ms. Smith said that the Healthy Families appropriation for FY 2005 was $13.8 million using both General Fund and TANF monies. Total expenditures from both the full appropriation and some of non-appropriated sources previously mentioned, is only $11.2 million. This is because some of the Healthy Family increases were slower getting started, and expenditures were lower than originally expected for FY 2005.

Representative Pearce asked Mr. Stavneak if the JLBC Staff recommendation makes up some of the shortfall that was there because of the Governor's veto in Children Services.

Mr. Stavneak said that was correct. There was a lack of clarity of intent when the FY 2005 budget was enacted. There is the perspective that the Governor never recommended funding for the program and recommended that it be found from other efficiencies.

Senator Cannell said that another issue is that DES has attempted to get people working and off the rolls and get kids adopted. They are making progress and the Legislature should support those efforts.

Mr. Stavneak said that there is an ongoing issue of what this means for the FY 2006 budget. In this case, the transfer was not incorporated in any numbers that were done for the FY 2006 budget. There is still a potential surplus and potential transfer that we would also face during FY 2006 as well.

<u>Senator Burns moved</u> that the Committee give a favorable review to the Department of Economic Security's request to transfer $12 million from the TANF Cash Benefit SLI with the provision that DES use non-appropriated fund sources and savings first to mitigate the projected shortfalls. The motion carried.

B. Review of Transfer of Appropriations between Child Care Subsidy Line Items.

Mr. Eric Jorgensen, JLBC Staff, said this item is a request for review of a transfer of $4 million of Federal Child Care Development Fund monies from the Day Care Subsidy line item to the Transitional Child Care SLI. Both of these line items are used to provide essentially the same services. Recipients of the TANF Cash Assistance are eligible for the Day Care Subsidy. However, once a family leaves the program they continue to be eligible for Transitional Child Care for 2 years. The surplus in the Day Care Subsidy program is about $7 million and the shortfall for the Transitional Child Care program will be between $3 million and $4 million.

Representative Gorman asked if this is related to the phantom day care waiting list or is it different.

Mr. Jorgensen said that it is the same program.

Mr. Stavneak said that we went from a waiting list to where we are now we have a $7 million surplus. He also said that in the Child Care budget we added dollars sufficient to fund about a 12% caseload growth. However, we are now seeing about a 6% growth. It is possible that there may be some surplus dollars in the Day Care line item during the course of FY 2006, depending on how caseload projections work out, because it is a caseload driven program.

Representative Tully asked if historically it has been about a 6% growth.

Mr. Stavneak said that is correct.

Representative Boone noted that basically this surplus is one time only for this year.

Ms. Smith said that both these line items provide the same service, (day care services, transitional child care and one that has a mix of people). It is all going to child care and nothing is being transferred out.

Senator Martin asked how they could go from a waiting list to a surplus in a very short span of time. He said that if the department knew the numbers had changed before the budget was being finalized the Legislature should have been informed of that.

Ms. Smith said that while a $4 million dollar transfer is a sizeable amount of money; it is only 3% of the program's budget. The reality is that it is very difficult for the department to anticipate what parents with children will choose to do. In terms of what steps are being taken to prevent this from happening next year, they would not be doing waiting lists so early in the year. They would be doing it later in the year when they have better information in order to estimate more accurately. DES believes the Legislature appropriated a sufficient amount for FY 2006. Ms. Smith said that in terms of FY 2006 they are not estimating that they will need any less money, there is caseload growth and they believe they need that dollar amount in FY 2006.

Representative Huffman noted that when the discussions on waiting lists were taking place, he thought part of the reason for the waiting lists was because of the nature of the families and children that the program serves. Because of family situations the children would get pulled out of the program and then end up being put back on a waiting list trying to get back in the program.

Representative Boone said that a waiting list should be created after you believe you have no more money in the program, it is a net number and now we find out there is a surplus.

Senator Burns moved *that the Committee give a favorable review to the Department of Economic Security's request for a $4 million transfer of appropriations between Child Care Subsidy Special Line Item to the Transitional Child Care Special Line Item.* The motion carried.

C. Review of Expenditure Plan for Discretionary Workforce Investment Act Monies.

Mr. Eric Jorgensen, JLBC Staff, said as a clarifying note the original request is written to be an addition to the FY 2005 expenditure plan that has just been revised to be the first piece in the FY 2006 expenditure plan, but all the rest of the information is pertinent and correct.

The Committee has favorably reviewed $4.9 million for the FY 2005 expenditure plan. This FY 2006 plan would be $184,900 in FY 2006 for the Jobs for Arizona Graduates (JAG program). The JAG program did receive funding from these Workforce Investment Act (WIA) monies in FY 2004 but was not included in the FY 2005 numbers. This program is to provide assistance to students who dropped out or are in danger of dropping out of high school.

Senator Waring asked how students are identified for the program since there is not enough money for every student that drops out to enter the program.

Mr. Jorgensen said that the JAG program is on a voluntary basis. JAG works with different school districts and students are identified through the counseling programs but it is voluntary to enroll in the program.

Senator Burns moved *that the Committee give a favorable review to the Department of Economic Security's expenditure plan for discretionary Workforce Investment Act Monies in FY 2006 with the provision that the department provide performance measures related to the program by September 1, 2005.* The motion carried.

DEPARTMENT OF HEALTH SERVICES – Review of Children's Rehabilitative Services Capitation Rate Changes.

Mr. John Malloy, JLBC Staff, said that this item is a review of the capitation rates for the Children's Rehabilitative Services program. He said that the adjustment falls within the FY 2006 appropriation.

Senator Burns moved *that the Committee give a favorable review to the Department of Health Service's request for review of the Children's Rehabilitative Services Capitation Rate adjustments.* The motion carried.

DEPARTMENT OF REVENUE (DOR) – Review of Ladewig Expenditure Plan

Mr. Bob Hull, JLBC Staff, said this item is a review of the Ladewig expenditure plan for FY 2006. The Ladewig Settlement Payments Budget Reconciliation Bill allocates $58.3 million in FY 2006 to the department for payments and costs associated with the case, with any unused amount to be held in reserve for future payments. The department is required to present an expenditure plan for review by the JLBC that includes an estimate and scope of the entire administrative requirement associated with disbursing payments and costs for this case, before expending any of the $58.3 million. The $58.3 million includes up to $1,758,900 for department administration costs and review of payments. The department has reduced the $1,758,900 to $1,424,700 by reducing their estimates for printing, postage and mailing costs. The $1.4 million might be reduced further if the department was not encountering some additional costs for overpayments that were made in FY 2005 for refunds to taxpayers.

The FY 2005 refunds include overpayments of about $6.3 million to 3,000 claimants due to clerical and calculation errors and computer matching errors. There is a court hearing scheduled for September 2005 to resolve issues involving that overpayment and whether the state will be able to collect that back from the taxpayers. The department is keeping separate track of administrative expenses related to costs associated with the overpayments.

Senator Cannell asked what the agency feels the chance is of getting these overpayments back.

Mr. Tom McGinnis, Project Administrator, DOR, said the purpose of the hearing is for the taxpayers to present their arguments on why they should not have to pay back the overpayments. He said he does not have a feeling for what the court will decide but it seems reasonable to believe the overpayments will have to be returned.

Representative Pearce said he has concerns with how this happened and if it has been corrected so it will not happen again in the future.

Mr. McGinnis said there were a number of pieces that affected the amount that taxpayers got. The major cause was the truncation issue. The data, that they spent millions of dollars capturing, was captured by the mainframe system in the 1980s. When they scanned the microfiche to create an electronic database, some fields in the microfiche had truncated numbers. DOR thought they had all the records identified and created manual work lists for people to go in and locate those records. Of all those records that had the truncated problem, there were 2 cases that went through. That is the bulk of the overpayment, $750,000 a piece for the 2 individuals. Most of the overpayments were small.

Representative Pearce said in a checks and balance system you would know if more money went out than was actually paid.

Mr. McGinnis said there were cases where the overpayment was so large, that they were overpaid more than the taxpayer paid but the total overpayment in those cases was small.

Representative Huffman asked if any safeguards have been put in place either before or after the overpayments.

Mr. McGinnis said they have corrected the problem. He said they have implemented 2 program modifications in the computer system. The first is when the system calculates the warrant amounts to be refunded, it compares it to what the actual payment is and determines if the warrant is a reasonable amount. Secondly, they individually look at all checks going out that are over $100,000. This system was not in place prior to the overpayments going out because of a court ordered deadline to mail out the refunds.

Senator Burns asked what the current total remaining Ladewig settlement cost is that DOR still owes.

Mr. McGinnis said the FY 2006 payout is about $51 million, plus about $5 million for attorney's fees. There will be another taxpayer payment in July 2006, which will include any unused set-asides for DOR's administrative costs and attorney's fees. The FY 2007 costs will be about $99 million.

Senator Burns asked what the total overpayment is and how it affects the total settlement costs.

Mr. McGinnis said the overpayment was $7.2 million.

Mr. Hull said that currently DOR has estimated the total Ladewig Settlement costs at $308.5 million. However, they are taking a look at how much of the overpayments might be included in that amount. It will depend on the ruling by the courts.

Senator Burns moved that the Committee give a favorable review as recommended by the JLBC Staff to the Department of Revenue's FY 2006 administrative expenditure plan for the Ladewig settlement. The Committee further requests that DOR report back to the Committee after the taxpayer refund overpayment issue has been resolved. The motion carried.

ARIZONA STATE RETIREMENT SYSTEM (ASRS) – Review of FY 2006 Information Technology (IT) Expenditure Plan.

Mr. Eric Jorgensen, JLBC Staff, said the ASRS has received an appropriation of $6,378,700 for FY 2006. This represents the fifth and final year of development funding under the approved project investment justification document.

The total development costs for this project is $40.6 million. Mr. Jorgensen said due to the Government Information Technology Agency's (GITA) concern as to the progress of the IT plan regarding the Public Employees Retirement Information System (PERIS) and the Financial Management System (FMS), they have changed the project status from "green" to "red" indicating a serious risk to the project being completed by the planned date.

Representative Gorman asked if the software for this project was done in-house.

Mr. Jorgensen said it was done in-house by state employees, as well as through external contracts.

Representative Tully asked who the vendor is for the PERIS system.

Mr. Jorgensen said that most of it was done in-house. The Financial Management System was done by an outside vendor. Mr. Jorgensen explained that ASRS hired a consultant who evaluated the system and determined that it was behind. At the request of the Information Technology Authorization Committee (ITAC), ASRS got a second opinion and the report of the second consultant will be released at the next ITAC meeting.

Mr. Anthony Guarino, Deputy Director, ASRS, said that at the initial review they essentially red-flagged themselves. As part of the implementation plan they brought on an advisory consultant. ASRS had 1 consultant for a couple of years who was giving them positive results. He eventually left for a different position. In June they brought in a new independent advisory consultant, and that consultant raised some concerns about project management issues, some vendor choices and some technology choices. The Director, at that time, organized a review and brought on an outside firm to do an independent assessment to resolve the issue and it was determined that concerns raised were almost completely unfounded. That assessment has been written up and will be presented to ITAC at their July meeting.

Representative Tully asked if the independent consultant was hired by ASRS.

Mr. Guarino said that was correct.

Senator Burns asked when they anticipate the red light turning green.

Mr. Guarino said he was confident that it will turn green at the July ITAC meeting.

Representative Pearce asked what the cost is for the overall project.

Mr. Guarino said that it is $40 million. In response to Representative Boone, Mr. Guarino said the start date of the project was when the funding became available on July 1, 2001, and the ending date is projected to be June 2006.

Representative Boone said it is a good idea to have in-house employees working on the project. Not being at the mercy outside vendors is a wise move.

Representative Gorman asked if the consultant that initiated the red flag was being paid a flat fee.

Mr. Guarino said that the consultant was paid an hourly wage.

Senator Burns moved that the Committee give a favorable review of the Arizona State Retirement System's Information Technology FY 2006 expenditure plan. The motion carried.

DEPARTMENT OF CORRECTIONS (ADC)

A. Report on Employee Overtime Pay and the On-Call Pay Settlements.

Mr. Kevin Bates, JLBC Staff, said this item was for information only and no Committee action was required. ADC received supplemental monies for compensatory time and on-call claims. ADC reports that $7.8 million was expended for FY 2004 employee compensatory time payments. One unresolved issue is compensatory time for FY 2005. ADC estimates that to be about $13 million. The Legislature has at least 2 options in this situation: they could increase

ADC's base appropriation or they could choose not to adjust their appropriation requiring the department to absorb the costs within its existing appropriation. The second issue is the on-call claims. ADC reports they have settled all but 3 claims regarding a lawsuit brought by current and former state employees who were not compensated for being "on-call."

Representative Pearce asked what the vacancy rate is at the different facilities.

Mr. Gary Phelps, Deputy Director, ADC, said the vacancy rate is getting worse every day, and at 2 facilities, Lewis and Winslow there is about 30% vacancy rate. ADC is mandating their officers to work in excess of 50 hours a week and they are losing 102 officers a month.

Representative Pearce asked what kind of savings the department has as a result of these vacancies.

Mr. Phelps said that they are working through that at this time. It will be mid July before they know what the savings are. He noted that until they get an adequate salary compensation plan this will continue to be an issue for them. He said that $7.5 million will be spent on the liability from last year, and they are still in the stipend and bonus phase of trying to retain officers, in addition, they have to cut 595 FTE.

Representative Pearce wants the Committee to be kept informed on the vacancy rate and how the dollars will be expended from unpaid vacancy positions.

Representative Pearce said that in 2004 ADC was to privatize the inmate stores and award a contract by November 1, 2004 and to privatize the stores by January 15, 2005. He asked if that has taken place yet.

Mr. Phelps said that the store contract was awarded on June 16, 2005.

Representative Pearce said the other issue is the 1000 new permanent private beds. In Special Session we had a prison crisis of a bed shortage. During that time we negotiated to fix that deficit. The deal between leadership and the Governor was that they would be rolled out virtually at the same time. At this time there is not even a contract out for the 1000 beds today.

Mr. Phelps said that the contract would be awarded today or tomorrow, they are still in final negotiations with the vendor. There was a holdup because of some VOI/TIS money and environmental quality issues and studies.

Representative Pearce said that the requirement to go forward to privatize the female prison is in statute. People spent a lot of money to compete on that bid and then they were told we were not going to go forward on it. People will not compete in Arizona if we do not follow the law to move forward on these issues.

Senator Cannell said he was at a meeting where this issue was discussed and one of the concerns was with women prisoners. They need to be near their families and continue to interact with their children. He also said they need to increase the compensation for correction officers.

B. Report on Monthly Bed Plan Update.

Mr. Stavneak said this item was not presented because JLBC Staff did not receive the report from the agency in time for the meeting.

Chairman Burns adjourned the meeting at 11:40 p.m.

Respectfully submitted:

Cheryl Kestner, Secretary

Richard Stavneak, Director

Representative Russell Pearce, Chairman

NOTE: A full tape recording of this meeting is available at the JLBC Staff Office, 1716 West Adams.

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FAX (602) 542-1616

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DATE: July 13, 2005

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Russell Frandsen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of FY 2006 Expenditure Plan for Workforce Investment Act Monies

Request

Pursuant to a footnote in the General Appropriation Act, the Department of Economic Security (DES) is submitting an expenditure plan for $2.3 million of the discretionary portion of federal Workforce Investment Act (WIA) monies received by the state for FY 2006. Unlike most Federal Funds, the WIA monies are subject to legislative appropriation due to federal requirements. DES has indicated that it will present an expenditure plan for an additional $1.3 million of WIA monies at a later JLBC meeting.

Recommendation

The JLBC Staff recommends a favorable review of DES' expenditure plan. The program activities and expenditure levels being sought seem reasonable and represent core functions typically funded by WIA dollars.

Analysis

The DES Workforce Development Administration is the state's grant recipient for federal WIA funds from the U.S. Department of Labor. Approximately $1.6 million of the $2.3 million expenditure plan is funding that would be passed through to the Arizona Department of Education (ADE), to local workforce investment areas, and to DES' Virtual One Stop Support and evaluation programs. The remaining $730,000 would be allocated to the Department of Commerce for staffing the Governor's Council on Workforce Policy (GCWP) and for apprenticeship programs.

(Continued)

Governor's Council Recommendation of 15% Set-Aside

Program Activities	Agency	FY 2005	FY 2006	Net Change
Eligible Training Provider List & Website	ADE	$ 127,000	$ 127,100	$ 100
Incentive Grants to LWIAs	LWIA	500,000	350,000	(150,000)
Technical Assistance and Capacity Building	LWIA	250,000	250,000	--
High Concentration of Eligible Youth	LWIA	200,000	150,000	(50,000)
Virtual One Stop Support	DES	325,000	300,000	(25,000)
Evaluation	DES	125,000	100,000	(25,000)
System Building	LWIA	300,000	300,000	--
Apprenticeship	ADOC	70,000	130,000	60,000
ADOC (staffing the Governor's Council on Workforce Policy)	ADOC	600,000	600,000	--
TOTAL 15% Set-Aside		**$2,497,000**	**$2,307,100**	**($189,900)**

Legend

ADE	*Department of Education*
DES	*Department of Economic Security*
LWIA	*Local Workforce Investment Areas*
ADOC	*Department of Commerce*

The above table delineates the FY 2006 level of funding by program and recipient and compares that total to FY 2005 levels. The expenditure plan represents core functions typically funded by discretionary WIA dollars. As noted from the table, the agency plans to increase Apprenticeship spending by $60,000 over FY 2005, while reducing funding by $(250,000) on 4 programs (Incentive Grants to LWIAs, High Concentration of Eligible Youth, Virtual One Stop Support, and Evaluation).

RS/RF:ck

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DATE: July 14, 2005

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: John Malloy, Fiscal Analyst

SUBJECT: Department of Health Services – Review of Behavioral Health Title XIX Capitation Rate Changes

Request

Pursuant to a footnote in the General Appropriation Act, the Department of Health Services (DHS) must present its plan to the Committee for its review prior to implementing any change in capitation rates for the Title XIX behavioral health programs. Capitation rates are the flat monthly payments made to managed care health plans for each Title XIX recipient. DHS is requesting review of rate changes for the Children's Behavioral Health (CBH), Seriously Mentally Ill (SMI), and General Mental Health/Substance Abuse (GMH/SA) Title XIX rates.

Summary

The proposed rates reflect utilization and inflation actuarial adjustments and DHS program changes. The proposed rates cost $15.1 million General Fund more than the $60 million capitation adjustment assumed in the FY 2006 budget. The Executive budget request contained $73.2 million in state match monies for growth, including monies to address the *Arnold v. Sarn* settlement agreement. The DHS proposal would therefore be comparable to the capitation funding in the Executive proposal.

The shortfall created by these higher than budgeted capitation rates will also depend on the FY 2006 enrollment trends. Current caseloads are running near budget, and as a result, the capitation rate increases are likely to result in a shortfall in FY 2006.

The weighted average of the capitation increases is 11.7% above FY 2005. In comparison, the preliminary capitation rate numbers reported by DHS, which were the basis of the FY 2006 budget, assumed an 8% capitation rate increase across the three behavioral health categories.

Beyond these actuarial adjustments for utilization and inflation, the rates reflect 3 main program changes:

- A special $13 million General Fund adjustment to Maricopa SMI rates as part of the Executive's proposed agreement to resolve the *Arnold v. Sarn* lawsuit;
- Transferring some of the Department of Economic Security's (DES) behavioral health responsibilities for foster care children to DHS, at a cost of $3.3 million General Fund;
- Transferring current county responsibility for behavioral health services in juvenile detention centers to DHS, at a cost of $1.6 million General Fund.

With these transfers, the state will begin to draw down federal funds for these activities.

Recommendation

The Committee has at least the following options:

1. A favorable review of DHS' capitation adjustments with no conditions. DHS would view this option as an endorsement of any potential supplemental request.
2. A favorable review with the stipulation that the favorable review does not constitute an endorsement of a supplemental request.
3. An unfavorable review. The Department is likely to proceed with the proposed increases even with an unfavorable review by the Committee.

With any option, the JLBC Staff recommends that DES and DHS report by October 1, 2005 on the savings that will accrue as a result of shifting services from DES to DHS.

Analysis

Since Title XIX is a federal entitlement program and states are required to provide reimbursement rates in managed care programs that are actuarially sound, capitation rates are not set by the Legislature. DHS contracts with an actuarial firm, which uses claims and encounter data and projected enrollment to determine the actual costs of services and thereby recommends increases or decreases in the capitation rates. Once DHS requests a change in rates, the new rates must be approved by Arizona Health Care Cost Containment System (AHCCCS). As directed by DHS, capitation rates may also include program expansions.

DHS has received approval from AHCCCS to change the capitation rates for CBH, SMI and GMH/SA, beginning July 1, 2005, and has submitted its planned capitation rate changes for the Committee's review. These rate changes will affect each Title XIX and Proposition 204 Special Line Item, and the Medicaid Special Exemption Payments Line Item.

Table 1 shows the budgeted and proposed capitation rates for each program. The FY 2006 appropriation was developed using preliminary capitation rate data reported by the department during the session, which assumed an 8.0% capitation rate increase above FY 2005.

Table 1

Capitation Rates

	FY 2005 Actual	FY 2006 Budgeted	% Change Above FY 2005	FY 2006 Final	% Change Above FY 2005
Children	$45.79	$49.45	8.0%	$50.71	10.7%
SMI	$63.11	$68.16	8.0%	$72.81	15.4%
General Mental Health	$30.04	$32.44	8.0%	$31.75	5.7%

<u>Children's Behavioral Health</u>
The proposed Children's rate increase is 10.7% above the actual FY 2005 budgeted rate, which is due to:

- A utilization trend increase of 10% from FY 2005 to FY 2006;
- A projected 13.1% increase in pharmacy related costs in FY 2006;
- Approximately 4,800 children that are Title XIX eligible that will be confined in detention centers (resulting in a $0.87 increase in cap rate);
- The transfer of certain behavioral health services from DES to DHS including:
  - 138 new children receiving therapeutic foster care (resulting in a $0.59 increase to the cap rate);
  - 500 children receiving counseling services (resulting in a $0.09 increase to the cap rate);
  - 333 children receiving Out of Home Care in DES that are eligible for Title XIX funding (resulting in a $1.06 increase to the cap rate);

Title XIX behavioral health services for foster care children are funded in the DHS budget. In FY 2003, funding for more intensive services began to be shifted from the DES budget to the DHS budget. Although the capitation rates were adjusted to reflect this shift, DHS now reports that the FY 2003 adjustments did not provide sufficient funding for these services. Therefore, the FY 2006 CBH rates have been adjusted upward (by an aggregate total of $1.74 per child per month, or $3.3 million General Fund) to reflect the increased costs associated with providing these new services. These services had been funded in the DES Children Services and Comprehensive Medical & Dental Program line items.

In addition to services being shifted from DES to DHS, DHS will begin to provide services to approximately 4,800 children who are eligible for Title XIX services that are anticipated to be confined to county detention centers in FY 2006, resulting in increased costs to DHS to provide these services. The cost to provide these services is approximately $1.6 million General Fund.

Providing these services through the Title XIX program in DHS allows the department to receive the standard Title XIX federal matching monies for any state dollars spent.

<u>Seriously Mentally Ill</u>
The proposed SMI rate increase is 15.4%, which is due to:

- Additional services provided to the SMI population in Maricopa County as part of an agreement with the Superior Court of Arizona related to the *Arnold v. Sarn* lawsuit. The services to be covered include residential, emergency, hospital and crisis, treatment, rehabilitation and support services. The adjustment for these additional services is $16.19 for Maricopa County, or $7.60 for the overall SMI population.
- A utilization trend increase of 2.7% from FY 2005 to FY 2006;
- A projected 9.7% increase in pharmacy related costs in FY 2006;
- Additional conversions from the Non-Title XIX program to the Title XIX program, which result in increased costs to the Title XIX program (an increase of $1.03 to the cap rate);

A Maricopa County Superior Court judge recently agreed to the Arizona Department of Health Services' completion dates for *Arnold v. Sarn* class action lawsuit. The lawsuit covers over 17,200 individuals with a Serious Mental Illness in Maricopa County, which is approximately 13% of all individuals served in Arizona. As part of that settlement agreement, DHS agreed to seek approximately $317 million in total funds to serve the SMI population in Maricopa County in FY 2006, an increase of $55 million (in all fund sources, including federal monies) over FY 2005.

According to JLBC Staff estimates, the enacted budget provided approximately $292 million in total funds for Maricopa SMIs in FY 2006. This included an increase of 8% for capitation rate growth and 2.4% for caseload increases. According to the Executive, the Governor's budget included capitation rate adjustments (20% for the SMI population) consistent with the $317 million Maricopa SMI spending agreement.

The rate adjustment being sought by the agency (a $16.19 per member per month increase to the capitation rate paid to the Maricopa County RBHA) would fulfill the requirements of the settlement agreement. The additional funds will be used to provide residential, emergency, hospital and crisis, treatment, rehabilitation and support services.

It is not clear if individuals meeting the same criteria as those covered by *Arnold V. Sarn* but living outside of Maricopa County will receive the same level of services as those living in Maricopa County.

In addition to the increases included above, the actuaries calculated a savings as a result of Medicare Part D, in which a new prescription drug benefit will be provided by Medicare for dual eligibles, resulting in prescription drug expenditures for this population to be reduced. This savings resulted in a decrease of $(2.13) to the cap rate in FY 2006. This savings (approximately $3.1 million General Fund) will not be realized, however, as federal law requires that most of these savings be returned to the federal government. As a result, the $15.1 million General Fund cost of the capitation rate change referenced in the Summary section does not include any savings from the implementation of Medicare Part D, as these savings will eventually be reimbursed to the federal government.

General Mental Health/Substance Abuse
The General Mental Health and Substance Abuse rate increased by 5.7% due to:

- A utilization increase of 5% from FY 2005 to FY 2006;
- A 3.6% increase in pharmacy related costs in FY 2006.

As with the SMI population, the actuaries calculated a savings as a result of Medicare Part D for the General Mental Health and Substance Abuse population, resulting in a decrease of $(0.62) to the capitation rate in FY 2006. This savings (approximately $1.1 million General Fund) will not be realized, however, as federal law requires that most of these savings be returned to the federal government.

Budget Impact
Table 2 shows the FY 2006 appropriated amounts for each population, as well as the JLBC Staff estimates of the cost by program above the FY 2006 appropriation, based on the enrollment projections that were used in developing the FY 2006 budget. Without changes to the enrollment projections and other assumptions used in developing the FY 2005 appropriation, the capitation rate changes will require an increase of $15.1 million from the General Fund and $45.8 million in Total Funds above the existing FY 2006 appropriation.

The actual costs of the new capitation rates may be higher or lower, depending upon the actual number of people that enroll in Title XIX behavioral health programs. The DHS actuaries estimate FY 2006 enrollment similar to what was budgeted.

Table 2

Statewide

	FY 2006 Appropriation		Estimated Need with Capitation Rate Changes	
	TF	GF	TF	GF
Children's Behavioral Health				
Title XIX	$265,932,200	$87,498,400	$274,262,900	$90,239,400
Proposition 204	3,146,900	1,035,400	3,248,800	1,068,900
Seriously Mentally Ill[X]				
Title XIX	161,122,000	53,013,200	179,806,100	59,160,600
Proposition 204	158,811,500	52,252,900	176,101,700	57,941,700
General Mental Health/ Substance Abuse				
Title XIX	80,839,300	26,598,200	81,320,700	26,756,500
Proposition 204	75,592,500	24,871,900	75,989,900	25,002,600
Medicaid Special Exemption Payments	15,850,300	5,215,200	16,396,700	5,395,000
Total	**$761,294,700**	**$250,485,200**	**$807,126,800**	**$265,564,700**
Difference			**$45,832,100**	**$15,079,500**

X – Maricopa SMI funding is a share of this amount plus other fund sources, which yields the $317 million spent in Maricopa in FY 2006

TF = Total Funds GF = General Fund Monies

RS/JM:ck

STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

http://www.azleg.state.az.us/jlbc.htm

DATE: July 14, 2005

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Shelli Carol, Fiscal Analyst

SUBJECT: Joint Legislative Budget Committee Staff – Report on Phoenix Medical Campus

Summary

The FY 2006 Higher Education Budget Reconciliation Bill (Laws 2005, Chapter 330) directs the University of Arizona (UA), based in Tucson, to establish a medical campus of its Health Sciences Center (AHSC) at the former site of Phoenix Union High School (PUHS). To support the Phoenix Medical Campus (PMC), Chapter 330 appropriates $6 million from the General Fund to AHSC, as well as $1 million from the General Fund to create the Arizona State University (ASU) Department of Biomedical Informatics.

The Arizona Board of Regents (ABOR) must submit for Committee review, by September 1, 2005, detailed operational and capital plans for PMC. *(Please see Attachment A.)* Of the $7 million appropriation for the new campus, Chapter 330 provided only $3.5 million on July 1, 2005. The remaining $3.5 million will become available upon the Committee's review of the PMC plans, but no later than October 5, 2005.

This agenda item provides the Committee with background information on PMC in advance of the September 1 deadline. UA and the City of Phoenix may also make preliminary presentations. The members will have the opportunity to raise additional issues for the September 1 submissions to address.

The highlights of the current PMC plan are as follows:

- Chapter 330 limited PMC to one class of 24 students, at an annual operating expense of $7 million.
- The first class will begin in fall 2006, housed in 90,000 square feet of 3 renovated buildings on a 4.8 acre campus.
- The City of Phoenix has supplied the property for a nominal annual fee, but UA and ABOR are responsible for renovating the 3 existing buildings, as well as possibly constructing 3 additional facilities.
- UA will finance the $19 million of renovations through lease payments of $16.25 per square foot, or $1.5 million per year, of which the Chapter 330 General Fund appropriation will pay $1.0 million.
- The original UA plan for PMC called for 196 students in 4 classes within 5 years, at an annual operating expense of $24 million. Furthermore, UA hoped to expand PMC enrollment to as many as 700 students, with possible annual operational costs upwards of $44 million, at an unidentified future date.

- PMC resides in the larger 15.8 acre Phoenix Bioscience Center, which the city owns and envisions could hold 1 million square feet, including: the existing TGen building; a joint university research facility, scheduled to begin construction later this summer; and two additional ABOR buildings not yet scheduled for construction.
- The Phoenix Bioscience Center plan includes a treatment facility. Options for patient services range from an outpatient clinic to a full teaching and research hospital, but no firm plan exists.

In mid-September, a joint subcommittee of this Committee and the Joint Committee on Capital Review (JCCR) will convene to discuss the September 1 plans in depth. This subcommittee will be able to spend more time reviewing PMC details than would be possible during a regular Committee meeting. The subcommittee will report its findings to the full Committee prior to formal review in late September or early October. *(Please see Attachment A.)*

To supplement the requirements of Chapter 330, JLBC Staff has prepared a list of suggested additional questions for the September 1 submission. *(Please see Attachment B.)*

PMC Detail

The Legislature, in Chapter 330, stated, "The Phoenix Medical Campus shall accommodate 24 first year medical students in instruction. The Phoenix Medical Campus shall continue to accommodate those 24 students through the remaining years of their instruction and clinical rotations." (Section 13.D) The Act also stated, "It is the intent of the Legislature that no more than $7,000,000 from the state General Fund be appropriated for the Phoenix Medical Campus in any fiscal year." (Section 13.G)

However, UA originally envisioned PMC expanding annually, through two levels. In Level I, enrollment and funding would grow, from FY 2006 to FY 2011, to fill all the space available at PUHS. This first level would eventually accommodate 48 lower division medical students, 148 upper division medical students (4 classes of 24 students, plus 100 upper-division students who complete their lower-division courses in Tucson, but choose clinical rotations in Phoenix), and 70 bioinformatics students. Level I would annually graduate 24 doctors at an operational expense of $24 million.

UA aims to begin the first PMC class in July 2006. UA will extend the curriculum and accreditation of AHSC to PMC. Additionally, PMC faculty will receive joint appointments at ASU and UA.

Table 1 summarizes the UA initial proposal for development of this first level.

Table 1

Phoenix Medical Campus Initially Proposed Level I Growth

	University of Arizona			Arizona State University			Total	
Fiscal Year	GF (M)	Lower Division	Upper Division [1/]	GF (M)	Undergrad	Grad	GF (M)	Students
2006	$ 6.0	0	0	$ 1.0	0	10	$ 7.0	10
2007	6.0	24	100	2.0	0	20	8.0	144
2008	8.5	48	100	3.0	0	30	11.5	178
2009	12.0	48	124	3.5	20	40	15.5	232
2010	16.0	48	148	4.0	20	50	20.0	266
2011	20.0	48	148	4.0	20	50	24.0	266

1/ Upper-division students include 100 per year who complete their lower-division courses in Tucson, but choose clinical rotations in Phoenix.

Level II, for which very little planning information exists, might accommodate 300 first and second year medical students, as well as 400 third and fourth year medical students. Level II might annually produce

150 doctors. This second level would require the construction of a new building, which a preliminary City of Phoenix estimate suggests might cost $150 million. UA has not yet provided any operational cost estimates for Level II. However, the UA College of Medicine, which graduates 110 doctors per year, receives an annual appropriation of around $44 million.

Level I Operations

Since no classes will run in FY 2006, the initial $7 million budget will finance startup expenses. Equipment, including specialized telecommunications infrastructure necessary for extension of the AHSC accreditation, will cost $3.8 million. UA will use another $2.2 million to hire PMC faculty and staff. ASU will use the remaining $1 million to hire faculty and staff for its Department of Biomedical Informatics. This new multidisciplinary department will incorporate the studies of computer science, biology, and engineering, to organize and analyze medical data.

Beginning in FY 2007, $1 million will finance lease costs, $0.9 million will cover general operating expenditures, $2.8 million will pay PMC faculty salaries, $1.3 million will fund PMC staff salaries, and $1 million will support the ASU Department of Biomedical Informatics. *(For the proposed UA and ASU cost breakdowns of future years, please see Attachment D.)*

Since 1992, UA has leased 17,000 square feet near 3^{rd} Street and Indian School Road in Phoenix to house 100 upper division medical students who complete their lower division courses in Tucson, but choose clinical rotations in Phoenix. UA will move these students, and their associated $2.8 million in annual funding, to PMC.

Level I Capital

The City of Phoenix took title to PUHS in 2002, but did not complete the purchase until 2003. The city used friendly condemnation, a legal procedure similar to eminent domain, to reduce the purchase price of the property to approximately $10 million.

PUHS is a 4.5-acre campus on the north side of Van Buren Street between 5^{th} and 7^{th} Streets in downtown Phoenix. The campus houses 3 buildings of 3 stories each, totaling 90,000 square feet. These facilities are under renovation to accommodate PMC.

Building 1, located on the west side of the site, will include a bookstore, library, administrative and financial aid offices, student common areas, and a pre-clinical training area with exam rooms. Building 2, located in the middle of the site, will contain interactive classrooms, meeting spaces, and a conference center. Building 3, located on the east side of the site, will provide space for student and faculty offices. New additions on the north side of buildings 1 and 3 will house elevators, disability access, and additional stairs. *(Please see Attachment C.)*

The city and UA have executed a series of 30-year leases on the site. The city leased PUHS to UA for $3 per year. The lease provides an option for extensions. At the conclusion of the lease, the City of Phoenix retains ownership.

UA sublet the property at the same $3 annual rate to a private developer, who began $19 million of renovations in March 2005. Of this expense, $1.8 million will purchase landscaping and other open space improvements. Since the private developer is financing the project, it qualifies for New Market Tax Credits, established by the federal government to encourage private investment in low-income areas. These credits reduced the cost of the work by around $4 million.

Based on the above amounts, the renewal project has a total cost per square foot of $211. Since renewal and renovation projects often combine both minor and major work, it is difficult to make meaningful comparisons among them. Other than the exterior walls, the developer is completely rebuilding the PUHS facilities. Therefore, JLBC Staff believes the per-square-foot costs for the project are reasonable. *Table 2* compares the costs of some assorted renovation projects.

Table 2

Selected Building Renewal/Renovation Projects
Estimated Per Square Foot Costs

Project	Total Project Cost	Total Cost Per Square Foot	Direct Construction Cost Per Square Foot
ASU-Backfill Space Renovation II	$ 3,800,000	$ 40	$ 24
Treasurer Renovations	360,000	42	34
UA-Residential Life Building Renewal Phase I	8,600,000	61	51
ASU-Academic Renovations & Deferred Maintenance Phase I	10,000,000	133	100
AVERAGE		***$137***	***$105***
NAU-School of Communication Building Renovations	14,020,000	154	131
Phoenix Medical Campus (PUHS Renovation)	**19,000,000**	**211**	**?**
ASU-Instruction/Research Laboratory Renovations Phase I	10,000,000	238	213
ASU-Instruction/Research Laboratory Renovations Phase II	11,447,000	293	185

Comments: Costs are not adjusted for general or materials inflation.

Once the buildings are complete, UA will lease them back from the private developer at a rate not to exceed $16.25 per square foot, inflation adjusted. For comparison, the state Lease Cost Review Board estimates the average per square foot cost for leasing privately owned space at $18.25 through FY 2007. Annual lease costs will be $1.5 million, which UA will pay with $1.0 million from the PMC General Fund appropriation and $0.5 million from locally retained tuition revenues.

Related ABOR Capital Projects

An intergovernmental agreement signed by the City of Phoenix and ABOR in February 2004 provides ABOR the option to construct three new buildings to the north of the PUHS site. The agreement provides ABOR the flexibility to withdraw without penalty, should the Legislature choose not to provide additional appropriations. The development leases may also include an option for ABOR to purchase the underlying land. JLBC Staff has requested copies of all leases.

Preliminarily, ABOR plans to construct the following facilities:

- Arizona Biomedical Collaborative Building 1 (ABC 1), a joint research facility of all three state universities. ABOR estimates that the 82,000 square foot structure would cost $26 million. ASU and UA have suggested they might exhaust the remainder of their research infrastructure debt capacity, as defined by Laws 2003, Chapter 267, to finance the facility. ABOR has not yet submitted this capital project for JCCR review. However, the board plans to begin construction later in the summer, with completion scheduled for early 2007.
- Arizona Biomedical Collaborative Building 2, an anticipated 100,000 square-foot facility. ABOR has not yet formally budgeted or scheduled this project.
- PMC Level II Expansion Building, an expected 150,000 square foot structure. ABOR has not yet formally budgeted or scheduled this project.

UA does not envision that PMC will include a teaching hospital, although the university is contemplating outpatient or limited inpatient clinics for a specialized program in cancer or neuroscience. UA believes its current affiliations with 9 hospitals in Phoenix will continue to provide sufficient clinical rotation positions and teaching resources.

Phoenix Bioscience Center

PMC and the ABC research complex are part of a larger City of Phoenix master plan called the Phoenix Bioscience Center. The center is a 15.8 acre site bounded by Fillmore, Van Buren, 5th, and 7th Streets in downtown Phoenix, adjacent to the ASU Downtown Campus at the Mercado. *(Please see Attachment C.)*

ABOR envisions that the Bioscience Center will also house the ASU College of Nursing, the ASU Nutrition Program, and the UA College of Pharmacy.

The city master plan states that the Phoenix Bioscience Center has a capacity 1,000,000 square feet. The plan allocates 500,000 square feet for research, 300,000 square feet for academic purposes, and 200,000 square feet for clinical research. Potential tenants already exist to fill around 2/3 of this space. ABOR would occupy 90,000 square feet at PMC, 182,000 square feet with the two ABC buildings, and 150,000 square feet with a new medical school facility.

The Translational Genomics Research Institute and the International Genomics Consortium, private non-profit medical research organizations, occupy a 170,000 square foot structure north of the planned ABC I site. Built and owned by the city, the facility opened in 2004. The City of Phoenix also plans a 50,000 square-foot specialized animal care facility at the center, as well as parking structures and space for private biotechnology companies or hospital branches.

According to a study conducted by a global health care consulting firm, the two greatest hurdles for the Bioscience Center will be a lack of space and the highly competitive Phoenix hospital market. The Health Sciences Center in Tucson, which does not house any non-profit or private medical organizations, is a 48-acre campus. The City of Phoenix master plan states the city's intention to expand the Bioscience Center seven blocks north of Fillmore Street and into the ASU Downtown Center. The city currently owns 10 additional acres in the area.

While UA does not plan to build a teaching hospital, the City of Phoenix has discussed new research and clinical facilities at the Bioscience Center with at least two Phoenix area hospital systems. If any UA-affiliated Phoenix hospitals feel undue competition from the center, they could respond by closing clinical rotation positions and withdrawing teaching resources.

Additional Requirements

Once the Committee completes its review in late September or early October, Chapter 330 requires ABOR to submit for Committee review, by December 31, 2005, a progress report on PMC. Thereafter, any significant changes to the operational plan must receive Committee review and any significant changes to the capital plan must receive JCCR review.

RS/SC:ck

Attachment B

Suggested Additional Questions for September 1 Phoenix Medical Campus Submission

Level I

- What is the status of UA clinical rotation agreements with affiliated Phoenix area hospitals? Have the hospitals guaranteed the necessary rotation positions?
- What options have UA and the City of Phoenix considered for patient services near PMC? What is the current view of the university and the city, and why?
- UA has stated it will contribute a cumulative $21 million for operating expenses and $17 million for capital expenses through FY 2011 from its existing budget. What is the annual distribution of these funds? Which monies will UA reallocate and what are their current purposes?
- Why do proposed Level I operational costs continue to escalate after PMC reaches maximum student capacity, from $16 million in Year 4 to $20 million in Year 5?

Leases

- Is the UA lease from the private developer a lease-purchase agreement? If so, what is the term of the agreement? If not, why not?
- Will UA terminate its current lease at 3rd Street and Indian School Road? If not, to what use will UA place the facility?

Phoenix Bioscience Center

- What exact space will house each of the ASU Department of Biomedical Informatics, the ASU College of Nursing, the ASU Nutrition Program, and the UA College of Pharmacy?
- Who owns the 7 blocks located to the north of Fillmore Street? What are the city's plans for acquiring the land?
- When can JCCR expect to review the Arizona Biomedical Collaborative Building 1 (ABC 1)? What will be the relationship between ABC 1 and the Phoenix Medical Campus?